

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

MAY 4 - 1934

Henry W. Hodges

CLERK

IN THE
**Court of Appeals of the
District of Columbia**

JANUARY TERM, 1934

No. 6181

516

Philadelphia National Bank, A Corporation, Assignee, Etc., Trust-
con Steel Company, A Corporation; McClintic-Marshall Corpora-
tion, A Corporation, et al., Appellants.

vs.

Robert W. McKinlay, Trustee of L. Balkin Company, A Corpora-
tion; Union Indemnity Company, A Corporation; Clay W. Beck-
ner and S. Sanford Levy, Receivers of the Union Indemnity Co.,
et al., Appellees.

Brief for Appellee, Robert W. McKinlay,
Trustee in Bankruptcy of L. Balkin Company,
A Corporation

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INDEX

	PAGE
STATEMENT OF THE CASE:	
I. Nature of the Proceedings.....	1
II. Question Involved.....	2
III. The Facts.....	3
ARGUMENT:	
I. When L. Balkin Company was adjudicated a bankrupt by the United States District Court for the Northern District of Illinois that court obtained jurisdiction of all the assets of L. Balkin Company and that court alone has jurisdiction to determine the rights of appellants whether by lien or otherwise in the fund owing by the United States under its contract with L. Balkin Company.	5
II. The assignment at the time of the execution of the bond by the bankrupt to the bonding company of deferred payments and retained percentages was void and ineffective for any purpose and is immaterial to the issue here involved	22
III. The transfer of L. Balkin Company to the surety company at the time the bond was executed of title to personal property to be acquired upon the construction project and to its rights under all future sub-contracts is immaterial to the issue in this case.....	24
CONCLUSION	26
APPENDIX (Section 270, Title 40, U. S. Code) ..	27

CASES CITED

	PAGE
American Bonding Co. of Baltimore vs. Central Trust Co., 240 Fed. 400.....	16
American Surety Co. vs. Owens, 62 App. D. C., 210; 61 W. L. R., 588.....	7, 8, 9, 10, 11
Belknap Hardware & Mfg. Co. vs. Ohio River Contract Co., 271 Fed. 144.....	15
Exchange State Bank vs. Federal Surety Co., 28 F. (2d) 485	24
Isaacs vs. Hobbs Tie & Timber Co., 282 U. S. 734	10, 22
Jordan vs. Gamble Latrobe, Receiver, 61 W. L. R. 819	12
London & Lancashire Indemnity Co. vs. Endres, 290 Fed. 98	23
Marble Company vs. Bergdorf, 13 App. D. C. 506	7
National Surety Company vs. Lane, 45 App. D. C. 176	18
Prairie State Bank vs. United States, 164 U. S. 227	17
Quinn vs. United States, 99 U. S. 30.....	18
Richards Brick Co. vs. Rothwell, 18 App. D. C. 516	7
Scott vs. Neely, 140 U. S. 106.....	12
Straton vs. New, 283 U. S. 318	22
United States Fidelity & Guaranty Co. vs. Bray, 225 U. S. 205.....	12
Weston, In re, 68 F. (2d) 913.....	10
Winter vs. Hazen-Latimer Company, 42 App. D. C. 469	20

STATUTES CITED

Code of Laws, District of Columbia, Section 1240	21
United States Code, Section 270 Title 40.3, 7, 11, 15,	25
United States Code, Section 203, Title 31.....	23

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PHILADELPHIA NATIONAL BANK, A CORPORATION, ASSIG-
NEE, ETC., TRUSCON STEEL COMPANY, A CORPORA-
TION; MCCLINTIC-MARSHALL CORPORATION, A CORPO-
RATION, ET AL., *Appellants*,

vs.

ROBERT W. MCKINLAY, TRUSTEE OF L. BALKIN COM-
PANY, A CORPORATION; UNION INDEMNITY COMPANY,
A CORPORATION; CLAY W. BECKNER AND S. SANFORD
LEVY, RECEIVERS OF THE UNION INDEMNITY CO., ET
AL., *Appellees*.

Brief for Appellee, Robert W. McKinlay,
Trustee in Bankruptcy of L. Balkin Company,
A Corporation

STATEMENT OF THE CASE

I

Nature of the Proceedings

Appellants, six in number, filed an amended bill of complaint in equity in the Supreme Court of the District of Columbia against this appellee, as trustee in bankruptcy of L. Balkin Company, a corporation, and

others, praying the appointment of a receiver to receive from the United States \$68,244.86, the balance determined to be due under a construction contract between the bankrupt and the United States. Appellants are creditors of the bankrupt under sub-contracts between them and the bankrupt and seek to have the aforementioned amount paid to them and others who furnished labor and material for the construction in question upon a *pro rata* basis. This appellee, as trustee in bankruptcy, moved to dismiss the amended bill of complaint and the lower court granted the motion. From the final decree dismissing the amended bill of complaint this appeal is prosecuted.

II

Question Involved

The sole question involved in the case is whether or not the Supreme Court of the District of Columbia has jurisdiction to administer for the benefit of part of the creditors of L. Balkin Company, the bankrupt, the amount owing by the United States upon the contract between the United States and L. Balkin Company when, before the institution of the proceedings in that court, L. Balkin Company had been adjudicated a bankrupt by the United States District Court for the Northern District of Illinois. The question is purely one of jurisdiction.

III

The Facts

On May 23, 1931, L. Balkin Company and the United States entered into a contract whereby L. Balkin Company agreed to construct and complete certain buildings at the United States Veterans Hospital at Canandaigua, New York, and the United States

agreed to pay L. Balkin Company for its services the sum of \$899,949.00 (R. 4).

L. Balkin Company, as principal, executed and delivered the usual bond required of Government contractors under Section 270 of Title 40 of the United States Code (R. 4, 5). The surety on this bond was the defendant below, New York Indemnity Company, whose obligation under the bond was reinsured by International Reinsurance Corporation and Union Indemnity Company, also defendants in the court below (R. 5, 6). Union Indemnity Company is now in receivership and is hopelessly insolvent (R. 9) and the affairs of the New York Indemnity Company, which has been dissolved and its charter forfeited, have been taken over by the Superintendent of Insurance of the State of New York (R. 9). International Reinsurance Corporation is hopelessly insolvent (R. 6).

L. Balkin Company entered upon the performance of its contract with the United States but on March 30, 1932, during the course of construction it failed to prosecute the work further and the contract was declared in default by the United States (R. 8). Thereupon the United States entered into a *new contract* with Union Indemnity Company acting in the name of the New York Indemnity Company for the completion of the work, and Union Indemnity Company completed the work under the new contract.

The appellants are six corporations, or their assignees, which entered into contracts with L. Balkin Company prior to its default for the furnishing of various materials and labor in the prosecution of the construction provided for in the contract between L. Balkin Company and the United States. All materials and labor provided for in these contracts had been furnished L. Balkin Company prior to its default except in the case of the appellant, Gray Knox

Marble Company, whose contract with L. Balkin Company had been performed to the extent of approximately one-third at the time of the default. After the bankruptcy of L. Balkin Company, defendant New York Indemnity Company entered into a contract with Gray Knox Marble Company for the furnishing of materials (R. 12). In the case of appellant, Federal Seaboard Terra Cotta Corporation, its contract with L. Balkin Company provided for the furnishing of labor and materials for which appellant was to receive \$35,000. Appellant completed its contract with L. Balkin Company before the default except for labor and materials of the value of only \$100.00 (R. 12, 13).

Summarized, the record shows that the contracts of all of the appellants were with the bankrupt, L. Balkin Company; that four of the appellants had completely performed their contracts with L. Balkin Company prior to default, that one of them had furnished all labor and material required by its contract with L. Balkin Company with the exception of labor and material to the value of \$100.00 and that another had substantially performed its contract with L. Balkin Company.

The total amounts claimed to be owing to the appellants by reason of their contracts with L. Balkin Company is approximately \$54,000.00.

There is still due and owing by the United States under the original contract between L. Balkin Company and the United States the sum of \$68,244.86 (R. 9).

The foregoing seems to this appellee to be the only facts pertinent to the issue in the case. However, some reliance is placed by appellants upon certain facts set forth in paragraph 18½ of the bill of complaint (R. 7). These facts are that at the time of the giving to the United States of the bond by L. Balkin

Company and the New York Indemnity Company as surety thereon, L. Balkin Company, the present bankrupt, assigned to the New York Indemnity Company (1) all deferred payments and retained percentages and all moneys or properties which might become due and owing to L. Balkin Company at the time of any breach or default in the said contract; (2) all title which L. Balkin Company might have in any personal property acquired in the course of the construction; and (3) its rights under all future sub-contracts into which it might enter.

On January 31, 1933, *prior to the institution of this suit*, L. Balkin Company was adjudged a bankrupt by the United States District Court for the Northern District of Illinois, Eastern Division, and Robert W. McKinlay, this appellee, was made trustee in bankruptcy of that company (R. 9).

ARGUMENT

I

When L. Balkin Company was adjudicated a bankrupt by the United States District Court for the Northern District of Illinois that court obtained jurisdiction of all the assets of L. Balkin Company and that court alone has jurisdiction to determine the rights of appellants whether by lien or otherwise in the fund owing by the United States under its contract with L. Balkin Company.

A correct result can be reached in this controversy only if the precise facts are at all times kept in mind and an exact alignment of the rights of the various parties observed. There is no better example of the confusion of thought into which one may slip in the case than the fact that appellants instead of presenting their own rights in the case devote almost their

entire brief to a presentation of what they conceive to be the rights of the sureties upon the bankrupt's bond.

All of the appellants are creditors of the bankrupt. Their claims arise out of the contracts which they had with the bankrupt for the furnishing of labor and material upon the Government construction. Two of the appellants are also creditors of the New York Indemnity Company by reason of independent transactions, one of these additional claims being insignificant (R. 13). Much is urged by the appellants as to the rights of the sureties on the bankrupt's bond to be subrogated to the rights of the United States but as will hereinafter appear it is only when the surety has met the obligations owing to sub-contractors that any right of subrogation accrues to the surety. In the case at bar appellants have not been paid by the sureties, all of whom are hopelessly insolvent.

With the minor exceptions noted the rights of all the appellants are against the bankrupt and the sureties of the bankrupt *qua* sureties. Appellant insists that one of the surety companies is entitled to the fund in question by reason of the independent contract into which it entered with the United States for the completion of the construction after the default of L. Balkin Company. If this be true all rights of the appellants in the fund or to be paid from the fund would cease because with respect to four of the appellants there is no privity between them and the surety company growing out of this independent contract and with respect to two of the appellants there is no privity with respect to a large portion of their claims. Appellants must seek their rights entirely by reason of the fact that L. Balkin Company, the bankrupt, entered into a contract with the Government and executed and delivered to the Government a bond with sureties conditioned upon completion of the work and

the payment of all sub-contractors of which the appellants are several. If the surety, New York Indemnity Company, by reason of its independent contract with the Government for the completion of the work may demand the money due under the contract of the Government with L. Balkin Company, then all rights of sub-contractors of L. Balkin Company are cut from under them because it is only by reason of the situation created by the giving of a bond by the general contractor pursuant to Section 270 of Title 40 of the United States Code (Appendix, *infra*) that any rights in the nature of liens or equitable charges upon the funds payable by the Government arise in favor of sub-contractors. *Marble Company v. Bergdorf*, 13 App. D. C. 506, *Richards Brick Company v. Rothwell*, 18 App. D. C. 516 at 537.

Fundamentally the relevant facts alleged in the amended bill of complaint are these:

L. Balkin Company entered into a construction contract with the United States. As required by the statutes, L. Balkin Company delivered to the United States a bond with sureties conditioned upon the payment by L. Balkin Company for labor and material. In the course of the construction L. Balkin Company entered into various sub-contracts with the appellants whereby appellants furnished labor and materials for which L. Balkin Company became obligated to pay. After the sub-contractors had furnished the labor and material and before payment therefor, L. Balkin Company defaulted on the contract and was adjudicated a bankrupt. The fact that the Government then entered into another and independent contract with one of the sureties for the completion of the work can in no wise enlarge or change the rights of the appellants.

These facts bring the case fundamentally within the decision of this court in the case of *American Surety Company v. Owens*, 62 App. D. C. 210; 66 F. (2d)

190; 61 W. L. R. 588. In that case one Gray contracted with the Government to perform certain work. The American Surety Company executed the contractor's bond required by the statute. The work was completed and accepted. At the time of completion and acceptance there was due from the Government to Gray approximately \$2,700 but Gray owed to subcontractors approximately \$5,000. Gray became bankrupt and was so adjudicated. Thereafter, the surety company filed a bill in the District Supreme Court seeking to enforce an equitable lien on the amount due to Gray from the Government. The District Supreme Court, after the intervention of Owens, the trustee in bankruptcy of Gray, claiming the fund, directed that the fund be paid to the trustee in bankruptcy. This court affirmed the lower court's disposition of the case. The basis of this court's decision was that, assuming that materialmen and laborers might have an equitable lien upon the fund payable to Gray and the bonding company might likewise have an equitable lien upon the fund after it paid laborers and materialmen, all of these liens should be adjudicated by the bankruptcy court.

The appellants in the case at bar insist that *American Surety Company v. Owens* has no application to their case because in that case Gray, the contractor, had completed his work, whereas L. Balkin Company had defaulted in its contract with the Government. This consideration, however, does not constitute a distinction between the case at bar and the *American Surety Company* case, *supra*. Appellants urge that a receiver should be appointed for the fund in question because one of the surety companies as an independent contractor, not *qua* surety, completed the work and expended sums in excess of the amount now held by the Government. In *American Surety Com-*

pany v. Owens the surety found itself liable to claims of materialmen and laborers in an amount almost twice as much as was due from the Government to Gray. Although American Surety Company was not required to complete the work either under an independent contract or by reason of the terms of the suretyship contract it was in precisely the same position as if it had had to complete the work because it had to pay creditors of Gray sums in excess of what Gray would receive from the Government. It is of small moment legally or practically to a surety of a Government contractor whether it spends money to complete work left unfinished by a defaulting bankrupt contractor or spends it to pay sub-contractors of a bankrupt contractor who has completed the work. Were appellants' contentions sound it would follow that the American Surety Company should have been awarded the \$2,700.00 owing by the Government to enable it to satisfy, as far as possible, the claims of sub-contractors. This is precisely what this court held was not the law. The money owed by the Government was awarded to the trustee in bankruptcy and the surety company and the materialmen and general creditors were referred to the bankruptcy court for an adjudication of their rights.

Appellants in the case at bar argue that the trustee in bankruptcy of L. Balkin Company could acquire no rights to the fund in question because L. Balkin Company had no right to the fund. L. Balkin Company, however, had just as much right to the fund in this case as Gray had to the fund in *American Surety Company v. Owens*. If materialmen and laborers had equitable liens to the extent of \$5,000 upon a fund of \$2,700, Gray, the bankrupt, certainly would have no interest in the fund. Nevertheless this court held that the fund should be sent to the bankruptcy court.

A recent case decided by the Circuit Court of Appeals for the Second Circuit in a large measure in reliance upon this court's decision in *American Surety Company v. Owens* bears out the necessity for leaving all questions of liens, equities and priorities to the bankruptcy court. In the case of *In re Weston*, 68 F. (2d) 913 (advance sheets of April 2, 1934) a contractor for the construction of work for the State of New York became bankrupt. At the time of the filing of the petition in bankruptcy the State owed the contractor for work already done. Shortly before and after the filing of the petition in bankruptcy numerous materialmen and laborers filed mechanics' liens under the Lien Laws of New York. When the petition in bankruptcy was filed there was no action pending to foreclose these liens. Shortly after the bankruptcy, however, one lienor began state court proceedings. The trustee in bankruptcy petitioned the court for an order permitting him to take proceedings to obtain the amount due to the contractor from the State of New York and to restrain lienors from asserting their rights in any tribunal other than the bankruptcy court. The District Court dismissed this petition. The Circuit Court of Appeals, however, citing the decision of this court in *American Surety Company v. Owens* and the decision of the Supreme Court in *Isaacs v. Hobbs Tie & Timber Company*, 282 U. S. 734, reversed the District Court and held that the bankruptcy court was entitled to receive the fund and that all lien holders must assert their rights in the bankruptcy court.

Thus, in the case at bar although appellants may have a lien upon the chose in action owing by the United States under its contract with L. Balkin Company and the surety companies may have an equity superior to the equity of all other creditors and these liens and equities may exceed, as was the case in

American Surety Company v. Owens, the amount in controversy, nevertheless the only court having jurisdiction to determine these liens and equities and to adjudicate payment is the bankruptcy court. If appellants do not have a lien upon the fund here in question by reason of the legal situation created when they supplied labor and materials to L. Balkin Company for Government construction, payment for which was secured by bond required by Federal statute, then appellants are without any right to proceed anywhere with respect to this fund. The only way in which appellants can acquire any right in the fund is by reason of the fact that money is owing to the bankrupt, their creditor, by the United States upon a construction project to secure the performance of which a bond was executed. It is only by reason of this situation that appellants acquire any rights other than general creditors of L. Balkin Company. They certainly can acquire no rights because of a *second contract* between the Government and the bonding company out of which their claims do not grow except in a very minor degree as hereinbefore mentioned with respect to two of the claimants. Even with respect to the comparatively small claim that two of appellants have against the bonding company for labor and material furnished the bonding company during the time it was completing the work, there would be no equity or lien in favor of appellants as far as any money owing by reason of the *second contract* to the bonding company by the United States is concerned. The United States apparently did not require the bonding company to give any bond when the independent contract was entered into by the bonding company and there is a grave doubt as to whether or not such a contract is valid at all in view of the provisions of Section 270 of Title 40 of the

United States Code (The Heard Act). As far as the second contract is concerned appellants are simply in the position of general creditors of the bonding company. The fact that the United States is the creditor of the bonding company gives the creditor of the bonding company no lien upon money owed to the bonding company by the United States or by any other person and the appellants may not proceed to have any such lien declared. The appellants' efforts to impose a lien upon a fund owing to the bonding company by reason of its second contract with the United States amounts to nothing more than a creditors' bill which may not be maintained until the appellants have secured judgments at law and execution is returned *nulla bona*. This has been recently decided by this court in the case of *Jordan v. Gamble Latrobe Receiver, et al*, 61 W. L. R. 819, which followed the well recognized rule enunciated in *Scott v. Neely*, 140 U. S. 106. Hence the appellants gain nothing by insisting upon any rights which the surety company may have against the United States growing out of the *second and independent contract* which the surety company executed with the United States for the completion of the work.

No decisions on all fours with the case at bar have been found either by appellee or appellants. However, the facts in one decision of the Supreme Court furnish an analogy to those in the case at bar. In *United States Fidelity and Guaranty Company v. Bray*, 225 U. S. 205, a situation not unlike the one in the case at bar was before the Supreme Court. Certainly the principal enunciated there applies to the one now before the court. In that case one who had contracted with the Government for construction work was unable to proceed with the work after it had been begun and became bankrupt. The trustees in bank-

ruptcy took charge under authority of the referee and proceeded to complete the work. The trustees in bankruptcy received from the Government the amount due under the contract. The trustees, however, had failed to make any profit on the contract. The surety company, becoming alarmed and fearing that amongst other things claims for labor and materials furnished in the execution of the Government contract for which it was liable under the bond it had given pursuant to Federal Statute (the same statute involved in this case) might not be paid instituted an independent suit in equity in which it claimed amongst other things as stated by the Supreme Court (p. 212).

“* * * that under the indemnity agreements made with it by the contractor, under the contracts with the Government and the bond given pursuant to the Act of August 13, 1894, *supra*, for their performance, and under the equitable doctrine of subrogation it has a lien on the fund remaining in the hands of the trustee, is entitled to have that fund applied to the payment of just claims for labor and materials as to which recourse can be had against it as a surety, and is entitled to every right and remedy which the Government or those who furnished the labor and materials would have against such fund; * * *

There were other reasons asserted by the bonding company, but this was the one principally considered by the Supreme Court. The principal prayer of the trust company was that the fund received by the trustee from the Government be declared subject to a lien for the payment of all just claims for labor and materials and that the net amount of the fund be applied to such claims. It will thus be seen that the surety company in this case was attempting to do even a less unusual thing than are the appellants in the case at bar for the trustee in the cited case simply desired the

court of equity to establish a lien upon the fund; whereas, the appellants in the case at bar desire the court to take the fund away from the trustee entirely or not permit him to have it and to place it in the hands of an equity receiver. The Supreme Court, after citing Sections 2, 23-a and 57-k of the Bankruptcy Act, said (p. 218):

“The allegations of the bill, other than those relating to the actions brought against the complainant in Pennsylvania and to its contingent claim against the indemnitor banks, are intended to invoke * * * (4) a direction that the just claims for labor and materials be accorded a preference in the distribution. These matters are rightly subjects for proceedings in bankruptcy and therefore fall within the exclusive jurisdiction of the court of bankruptcy. A distinct purpose of the Bankruptcy Act is to subject the administration of the estates of bankrupts to the control of tribunals clothed with authority and charged with the duty of proceeding to final settlement and distribution in a summary way, as are the courts of bankruptcy. Creditors are entitled to have this authority exercised, and justly may complain when, as here, an important part of the administration is sought to be effected through the slower and less appropriate processes of a plenary suit in equity in another court, involving collateral and extraneous matters with which they have no concern, such as the controversy between the complainant and the indemnitor banks.

“Of the fact that the suit was begun in the Circuit Court with the express leave of the court of bankruptcy it suffices to say that the latter was not at liberty to surrender its exclusive control over matters of administration, or to confide them to another tribunal.”

As indicated by the Supreme Court in this case, creditors of a bankrupt are entitled to have the priorities and liens determined by the bankruptcy court.

The fact that the trustee in bankruptcy is a party to the present proceeding is clearly indicative of the fact that he must have some interest in the fund or in the outcome of the litigation. If the trustee in bankruptcy can be compelled to defend suits of this sort in the District of Columbia, he can be compelled to defend them in every Federal Court in the United States and can be compelled to appear in every Federal Court of the United States and litigate his rights to the possession of funds. This is the very thing the Supreme Court in the cited case holds can not be done.

Appellants cite numerous cases which they believe support their contention in this case. An example of those cases, however, will indicate that they have very little bearing upon the case at bar. All of the cases cited go to the merits of the particular situation and in no instance is the question of jurisdiction decided or discussed.

In *Belknap Hardware and Manufacturing Company v. Ohio River Contract Company*, 271 Fed. 144, an equity receiver was appointed for the general contractor and took over and completed the work required by the contract and received the balance due by the Government to the contractor. Thereupon the materialmen and laborers whose claims had accrued prior to the receivership filed a bill of complaint against the receiver praying that the fund which had been received from the Government by the receiver be paid into the court and their claims given priority. The Circuit Court of Appeals held that materialmen and laborers were entitled to a priority under the statute (The Heard Act, Section 270, Title 40, U. S. Code, Appendix, *infra*) but held that the fund must be administered in the receivership proceedings. In reversing the lower court which had refused to allow priority the Circuit Court of Appeals said:

“* * * the case may be remanded, in order that the claimants may recast their pleading, so as to be in form either an intervention in the receivership case, or an independent bill *expressly ancillary* to that case * * *.” (Italics supplied.)

It will thus be seen that this case is not helpful to the contention of the appellants. If anything, it is quite contrary to their contention for while bankruptcy proceedings were not involved receivership proceedings were and the court held that the fund must be administered in the receivership proceedings. This case is one of the clearest reasoned cases upon the proposition that the equities and liens of materialmen and laborers arise by reason of the circumstances brought about by the provisions of the Heard Act and not upon any general principles of law.

In *American Bonding Company of Baltimore v. Central Trust Company*, 240 Fed. 400, another case relied upon by appellants, a bankrupt had completed construction upon a Government project and the Government had accepted the work. The bonding company had paid part of the claims for labor and material and thereupon the bonding company and materialmen filed a petition asking that their claims be given priority in the distribution of the fund *which the trustee had received* from the Government. The court allowed this priority but the striking thing about this case is the fact that the trustee had the fund and the bankruptcy court is the court which determined the priorities and liens. The contention of this appellee is that the bankruptcy court should determine appellants' priorities. There is no question now before this court as to whether or not appellants have liens or priorities. The only question before this Court is one of jurisdiction as to what court should determine the issues.

Another case upon which great reliance is placed by

appellants is *Prairie State Bank v. United States*, 164 U. S. 227. An examination of the facts and decision in this case will indicate that it has no bearing upon the case at bar. In that case the general contractor and the United States entered into the contract in 1888 for the erection of certain buildings for a specified sum of money, ten per cent to be retained until completion and acceptance of the work and to be forfeited if the contract was not fulfilled. In 1890 the general contractor gave to the Prairie State Bank a power of attorney and order to receive the final payment on the contract in consideration of advances made or to be made by the bank. Thereafter during 1890 the bank advanced substantial sums of money to the contractor although it did not appear that this money was used in the performance of the contract. In May, 1890, the contractor defaulted and the contractor's surety (who had been provided for in the general contract not under any statute, the original Heard Act not having been passed until 1894) completed the contract and spent a considerable sum of money in excess of the current payments from the Government. The question was whether or not the retained amounts in the possession of the Government should be paid to the surety or to the bank which had previously lent money to the contractor. The Supreme Court held that the surety's rights were superior to those of the bank, the surety being subrogated to the rights of the United States against the retained funds. There are several circumstances which must be noted with respect to this case. First, it arose before the enactment of the Heard Act. Second, no bankruptcy proceedings were involved. Third, no rights of materialmen and laborers upon the Government contract were involved. Fourth, the surety completed the work under the general contract and not under an independent contract made between

the surety and the Government after the default as is the situation in the case at bar.

It will thus be seen that the *Prairie State Bank Case* has no application to the case at bar. No question of jurisdiction was involved in that case. There is no contention by appellee that a surety who fulfills the obligation which the principal has failed to fulfill is not subrogated to the rights of the obligee against the principal but in the case at bar the surety company's claim is not one of subrogation but a claim under its own contract against the Government. The surety company has not paid appellants nor will the surety company's nor appellants' rights be prejudiced merely because they must seek them in the bankruptcy court in Illinois rather than in the Supreme Court of the District of Columbia. None of the appellants is a resident of the District of Columbia.

Another case relied upon by appellants is *Quinn v. United States*, 99 U. S. 30. This case is without application to the case at bar. The Government in that case had retained certain percentages of the consideration provided for in the general contract. The contractor defaulted. He had been paid for all the work actually done. The Government completed the work at a profit. The contractor sued the Government to recover the retained percentages and the profit. While he was not allowed to recover the profit, the court held that the retained percentages should be paid to the contractor.

The case upon which appellants place greatest reliance is the decision of this court in *National Surety Company v. Lane*, 45 App. D. C. 176. In that case the contractor became bankrupt during the execution of the work. The surety company thereupon entered into a contract with a third party to complete the work, the contractor of the surety company to receive the unearned portion on the original contract

plus a sum retained by the Government on the original contract, plus a penalty which had been charged by the Government, plus an additional payment by the surety company. This contract was conditioned upon the surety company being able to enter into a contract with the Government. The surety company entered into a contract with the Government to complete the work under the original contract, the Government to pay the unearned sum on the original contract and the retained sum. The original contractor had, in the meantime, become bankrupt. The question in the case was whether or not, under these circumstances, the surety company or the trustees in bankruptcy for the original contractors were to receive from the Government the retained sums, these sums being amounts which the Government had held back on payments which had become due the original contractor. The court held that the surety company was entitled to these retained sums.

There are certain important considerations which distinguish the *Lane* case from the case at bar and these distinctions really determine the case:

1. No claims of sub-contractors were involved;
2. The surety company had entered into an independent contract with a third party for the completion of the work under which contract the surety company alone was liable to the third party;
3. No amount was due sub-contractors for labor or material furnished under contracts with the original contractors, and;
4. This court when deciding the case had before it no question of jurisdiction.

In the case at bar the contracts of all the appellants were originally made with L. Balkin Company, the bankrupt. With one exception, as far as the allegations of the amended bill of complaint show, the

bonding company did not assume any of the contracts of the plaintiffs. In one instance, in the case of the appellant Gray Knox Marble Company, the original contract had been entered into with L. Balkin Company, the bankrupt, and materials of the approximate value of \$5,000.00 had actually been furnished to L. Balkin Company. After the bankruptcy, the surety company did enter into a contract with Gray Knox Marble Company which involved the payment to Gray Knox Marble Company of \$14,000.00, \$10,150.00 of which has been paid (R. 12).

With respect to the appellant, Federal Seaboard Terra Cotta Corporation, the contract was entered into with L. Balkin Company, the entire amount due under said contract being \$35,000.00. This appellant completed its contract with L. Balkin Company to the extent of \$34,900 worth of materials. No contract with the surety company is alleged, but it is alleged that of the \$35,000.00 worth of materials, only \$100.00 worth was furnished to the completing surety (R. 13).

It will thus be seen that, with the exception of the comparatively minor instance referred to, the rights of all the sub-contractors depend upon the original contract. They have no rights under any contract against the surety company except the suretyship contract of which L. Balkin Company was principal. If the surety company entered into an independent contract with the Government separate and distinct from the original contract, then only the surety company's own contractors have any claim against it.

Another case relied upon by appellants is *Winter v. Hazen-Latimer Company*, 42 App. D. C. 469. A careful examination of this case will indicate that it has no bearing whatsoever upon the present situation, but involves simply an interpretation of the Mechanics Lien Law of the District of Columbia. The suit was instituted to secure the declaration of a lien upon a

fund. The contract had been entered into between the owners of property and a contractor for the erection of a building. The contract provided that part payments on the contract were to be made during various stages in the progress of the work. The first payment was to be made when the first floor joists were laid. The plaintiff who was attempting to have the lien declared was a sub-contractor which had completed its work before the first floor joists were laid. The sub-contractor, however, had given no notice of its claim to the owners who, without such notice, paid the amount due on the first payment to the contractor who then absconded. The surety on the contract of the contractor had the specific right, under the terms of the bond, to complete the work and to receive all future payments from the owner. The surety elected to complete and did receive future payments from the owner. In passing, it should be noted that this case differs from the one at bar in that in this case there was a specific provision in the bond that the bonding company might complete. The only question in the case was whether or not the sub-contractor had a lien on the future payments, not having given notice to the owners prior to the time the owners made the first payment. The question became purely one of the construction of Section 1240 of the District of Columbia Code. This section provides:

“SEC. 1240. *Conditions.* All such liens in favor of parties so employed by the contractor shall be subject to the terms and conditions of the original contract except such as shall relate to the waiver of liens and shall be limited to the amount to become due to the original contractor and be satisfied, in whole or in part, out of said amount only; and if said original contractor, by reason of any breach of the contract on his part, shall be entitled to recover less than the amount agreed upon in his contract, the liens of said parties so

employed by him shall be enforceable only for said reduced amount, and if said original contractor shall be entitled to recover nothing said liens shall not be enforceable at all.”

The court held that the sub-contractor, having given no notice to the owners of his right to receive a portion of the first payment, was not entitled to a lien upon future payments there being no showing that the contractor was entitled to any such portion.

Upon the general proposition that only a bankruptcy court has jurisdiction to administer funds involved in the bankrupt's estate the court's attention is respectfully directed to the case of *Isaacs v. Hobbs Tie and Timber Company*, 282 U. S. 734, and *Straton v. New*, 283 U. S. 318.

From the foregoing considerations it is respectfully submitted that it is quite clear that the decree of the lower court was correct. Appellants' rights are primarily against the bankrupt. Their claims to priority are against a fund growing out of a contract between the bankrupt and the United States. That priority or lien must be determined in the bankruptcy court where any conflicting rights between the appellants and the bankrupt may be adjudicated.

II

The assignment at the time of the execution of the bond by the bankrupt to the bonding company of deferred payments and retained percentages was void and ineffective for any purpose and is immaterial to the issue here involved.

The alleged assignment by L. Balkin Company to the bonding company of deferred payments and retained percentages due from the Government can have no bearing whatever on the general situation

since the assignment was null and void under Section 3477 of the Revised Statutes, Section 203 of Title 31, U. S. Code. This section provides:

“Assignments of claims void. All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share, thereof, except as provided in Section 204 of this title, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgments of deeds, and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgment, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same. The provisions of this section shall not apply to payments for rent of post-office quarters made by postmasters to duly authorized agents of the lessors. (R. S. Sec. 3477; May 27, 1908, c. 206, 35 Stat. 411.)”

The nullity of such assignments made to bonding companies has been established by the decisions. In *London and Lancashire Indemnity Company v. Endres*, 290 Fed. 98, decided by the Circuit Court of Appeals for the Eighth Circuit, the court had before it the effect of an assignment at the time of the giving of the bond by a principal to a bonding company as

in the case at bar. The Circuit Court of Appeals said (pp. 101-102):

“We think the assignment of the contractor’s rights and property to the surety made in the application to it to become surety gave no rights or claim to the appropriation, first, because there was no such intention in the minds of the parties when the application was made and the surety became bound; and, second, *the purported assignment being purely contractual was void under Section 3477 supra* [of the Revised Statutes].” (Italics supplied.)

In *Exchange State Bank v. Federal Surety Company*, 28 F. (2d) 485, decided by the Circuit Court of Appeals for the Eighth Circuit, the Court in holding that an assignment such as the one relied upon in the case at bar had no bearing upon the general situation, said (p. 487):

“Such, we think, is the proper construction to be placed upon the assignment agreement in the bond application in the case at bar. That the equitable lien may be enforced, though an assignment agreement exists, has been held in numerous cases. [Case cited.] We have not been cited to any case holding the contrary. It may, indeed, be doubted whether such assignment agreements in surety bond applications can be given any force, except the limited one above indicated.”

III

The transfer of L. Balkin Company to the surety company at the time the bond was executed of title to personal property to be acquired upon the construction project and to its rights under all future sub-contracts is immaterial to the issue in this case.

The allegation in the second half of paragraph 18½ of the bill of complaint (R. 7) that L. Balkin Company

also assigned to the bonding company at the time the bond was executed all of its rights under sub-contracts and in property acquired under sub-contracts in the event of default by L. Balkin Company likewise can have no effect upon the situation here. It is a little difficult to see the materiality of these allegations. They do not go far enough to set forth a novation so that the contracts between the sub-contractors and L. Balkin Company would be transferred to the bonding company and thereby all liability of L. Balkin Company cease. There could be no such novation because at the time the bond was secured certainly many of the sub-contracts had not been secured by L. Balkin Company. Furthermore, there was no relationship whatsoever between the sub-contractors and the United States which does not recognize claims of sub-contractors in making payments under general contracts, the only right of sub-contractors being that provided against the bonding company in Section 270 of Title 40, U. S. Code. There is no allegation, however, that the appellants who were sub-contractors ever agreed to a novation of this sort. There would be no object in the appellants agreeing to such a novation since, in the event of default, they had full rights against the bonding companies. The plaintiff's rights as well as the rights of all other sub-contractors against the bonding companies were rights against the bonding company *qua* surety. An assignment of the sub-contracts by the principal at the time he secured the bond would neither add to nor detract from the rights of the sub-contractors, of whom the appellants are six. Hence, it is difficult to understand how these allegations can help the appellants' case.

CONCLUSION

The decree of the Supreme Court of the District of Columbia should be affirmed.

Respectfully submitted,
May 4, 1934.

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APPENDIX**Section 270, Title 40, United States Code**
(The Heard Act)

§270. Bonds of contractors for public buildings or works; rights of persons furnishing labor and materials. Any person or persons entering into a formal contract with the United States for the construction of any public building, or the prosecution and completion of any public work, or for repairs upon any public building or public work, shall be required, before commencing such work, to execute the usual penal bond, with good and sufficient sureties, with the additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them with labor and materials in the prosecution of the work provided for in such contract; and any person, company, or corporation who has furnished labor or materials used in the construction or repair of any public building or public work, and payment for which has not been made, shall have the right to intervene and be made a party to any action instituted by the United States on the bond of the contractor, and to have their rights and claims adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the claim and judgment of the United States. If the full amount of the liability of the surety on said bond is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the United States, the remainder shall be distributed pro rata among said interveners. If no suit should be brought by the United States within six months from the completion and final settlement of said contract, then the person or persons supplying the contractor with labor and materials shall, upon application therefor, and furnishing affidavit to the department under the direc-

tion of which said work has been prosecuted that labor or materials for the prosecution of such work has been supplied by him or them, and payment for which has not been made, be furnished with a certified copy of said contract and bond, upon which he or they shall have a right of action, and shall be, and are hereby, authorized to bring suit in the name of the United States in the district court of the United States in the district in which said contract was to be performed and executed, irrespective of the amount in controversy in such suit, and not elsewhere, for his or their use and benefit, against said contractor and his sureties, and to prosecute the same to final judgment and execution: *Provided*, That where suit is instituted by any of such creditors on the bond of the contractor it shall not be commenced until after the complete performance of said contract and final settlement thereof, and shall be commenced within one year after the performance and final settlement of said contract, and not later; *And provided further*, That where suit is so instituted by a creditor or by creditors, only one action shall be brought, and any creditor may file his claim in such action and be made party thereto within one year from the completion of the work under said contract, and not later. If the recovery on the bond should be inadequate to pay the amounts found due to all of said creditors, judgment shall be given to each creditor pro rata of the amount of the recovery. The surety on said bond may pay into the court, for distribution among said claimants and creditors, the full amount of the sureties' liability, to wit, the penalty named in the bond, less any amount which said surety may have had to pay to the United States by reason of the execution of said bond and upon so doing the surety will be relieved from further liability: *Provided further*, That in all suits instituted under the

provisions of this section such personal notice of the pendency of such suits, informing them of their right to intervene as the court may order, shall be given to all known creditors, and in addition thereto notice of publication in some newspaper of general circulation, published in the State or town where the contract is being performed, for at least three successive weeks, the last publication to be at least three months before the time limited therefor.